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Supreme Court of the United States

OCTOBER TERM, 1941.

No.——

AFFILIATED ENTERPRISES, INC., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

SUMMARY STATEMENT OF MATTER INVOLVED.

The respondent here was the petitioner below and will be referred to hereafter as the Commissioner. The petitioner here was the respondent below and will be referred to hereafter as the taxpayer.

This case involves the construction of the word "royalties" in the personal holding company statute, designated as Section 351-1 of the Revenue Acts of 1934 and 1936, and of the word "rents" and the words "other like property" in the Regulations promulgated pursuant thereto.

The applicable portion of said Section 351-1 in the Act of 1934, C. 277, 48 Stat. 680 (the Act of 1936 being the same in this connection), reads as follows:

> "The term 'personal holding company' means any corporation * * * if (A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities, and * * * (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals" (R. 95).

More than 50% of the outstanding stock of the taxpayer was owned by not more than five persons during the taxable years in question.

The Commissioner having proposed a deficiency under said Section 351 against the taxpayer as a personal holding company for the years 1934, 1935 and 1936, on the ground that the taxpayer's income was from "royalties" as used in said personal holding company statute, the taxpayer filed its petition before the Board of Tax Appeals, which, on July 19, 1940, held that the taxpayer's income was not from royalties and that it was not subject to said Section 351, in Affiliated Enterprises, Inc. v. Commissioner, 42 B. T. A. 390 (R. 69).

The Commissioner then filed a petition for review with the United States Circuit Court of Appeals of the Tenth Circuit, which, by a majority decision, with one judge filing a written dissenting opinion, reversed the decision of the Board of Tax Appeals on November 11, 1941 (R. 94).

A petition for rehearing was filed December 8, 1941 (R. 113), and denied December 16, 1941 (R. 114).

The taxpayer was incorporated November 16, 1933, "for the purpose of promoting the use by theaters throughout the United States" (R. 17) of a system of free giveaways, operated under the name of Bank Night in most localities, but also operated under the name of Prosperity Night, Bank Day or Cash Night in other localities where those names were more suitable.

The taxpayer, during the years 1934, 1935 and 1936, involved here, entered into written agreements with theater owners whereby each theater owner agreed to pay to the

taxpayer a stated weekly sum for each theater, which was as low as $5 per theater in some instances and as high as $10 per theater in other instances (R. 11, 20).

In return for said weekly payment, the taxpayer furnished the theater owner for each theater an initial set of supplies, and thereafter gave advice and consultation as to the method of using the system in the locality involved and at its expense provided legal defense against lottery charges, if any (R. 20). Additional supplies were furnished at agreed prices (R. 20). The supplies included register books, record books and tickets, which were not copyrighted, and film trailers, some of which were copyrighted February 19, 1934, but not used after September 1, 1934 (R. 20). The only copyrighted articles used during the three years in question were instruction sheets, which described the method of using the system and were delivered to the theater manager for the purpose of acquainting him therewith. Said copyrighted sheets were not exhibited to the public. Applications to patent the system were denied (R. 21).

The method of operating the system could be learned by attending a theater using the system, and from the outset it was generally contended by theater owners throughout the United States that the taxpayer did not have the exclusive right to the use of said system (R. 19).

For this reason, these agreements were for stated weekly amounts, and were not based upon the substantial increased profits which resulted from the use by the theaters of said system, supplies and services (R. 19).

The taxpayer contended before the Circuit Court, as it had before the Board of Tax Appeals, which sustained said contention, that the taxpayer's income was from "rents," because approximately 86% of the taxpayer's income in 1934, 95% thereof in 1935 and 98% thereof in 1936, had been received from uniform weekly payments made by theatre owners in stated amounts without reference to the extent of use of the system, supplies, services, etc., provided by the taxpayer, nor the amount of income received by the theater as a result thereof (R. 25).

This contention was based upon two decisions of this Honorable Court which have been followed uniformly in

departmental decisions pertaining to personal holding company income, namely:

Duffy v. Central Railroad Company, 268 U. S. 55, 45 S. Ct. 429, 5 A. F. T. R. 5377, decided in 1925, in which this Court said:

> "The term 'rentals,' since there is nothing to indicate the contrary must be taken in its usual and ordinary sense, that is, as implying a fixed sum or property amounting to a fixed sum, to be paid at stated times for the use of property."

Thereafter, on December 5, 1938, in M. E. Blatt Company v. U. S., 305 U. S. 267, 59 S. Ct. 187, 21 A. F. T. R. 1007, this Honorable Court said:

> "Rent is a 'fixed sum or property amounting to a fixed sum, to be paid at stated times for the use of property * * *. It does not include payments uncertain both as to amount and time made for the cost of improvements * * *.'"

Although the Circuit Court recognized that the taxpayer essentially was an operating company engaged in promoting the use of an advertising system throughout the United States, and that the taxpayer had no income from royalties as such, nevertheless, the Circuit Court held that the taxpayer had a property right in said system (R. 97), and was subject to the personal holding company statute upon the ground that its income was included in the words "other like property" (R. 99), contained in the following extract from Treasury Regulations 86, Art. 351-2, (1) promulgated under the Revenue Act of 1934 defining royalties:

> "(1) Royalties.—The term 'royalties' includes amounts received for the use of or for the privilege of using patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. It does not include rents, nor overriding royalties received by an operating company. As used in this paragraph, the term 'overriding royalties' means amounts received from a sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid."

Substantially the same provisions are contained in Article 351-2 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, insofar as material in this case.

This inclusion by the Circuit Court of the taxpayer's income in the words "other like property" in the Regulations was made without reference by the Circuit Court to the fact that "rents" are excluded from personal holding company income in said Regulations, because of the refusal by Congress to include "rents" in personal holding company income, in order that operating companies might not be affected by the personal holding company statute.

This is a petition for a writ of certiorari to review the above opinion of the United States Circuit Court of Appeals for the Tenth Circuit.

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

1. This case presents questions of the first importance relating to the meaning of the word "royalties" in the personal holding company statute and the meaning of the word "rents" and the words "other like property" in the regulations promulgated pursuant thereto, which have not heretofore been passed upon by this Court.

An early authoritative decision of these questions by this Court is of pressing importance, not only to the parties to this cause, but also to many companies engaged in the oil industry and the mining industry, having not more than five stockholders, who have relied upon the decisions of this Court with reference to the definition of rentals, and departmental rulings based thereon in allocating their income for income tax purposes.

2. Aside from the novelty and importance of the issues presented, the opinion below should be reviewed for the additional reason, we submit, that it is clearly erroneous and not in accord with the principles of applicable decisions of this Court.

To the extent that the opinion below designates stated

payments to be "royalties," said opinion is not in accord with the decisions of this Court in the following cases:

Duffy v. Central Railroad Company, 268 U. S. 55, 45 S. Ct. 429, 5 A. F. T. R. 5377, decided in 1925.

M. E. Blatt Company v. U. S., 59 S. Ct. 187, 305 U. S. 267, 21 A. F. T. R. 1007, decided December 5, 1938.

3. In addition to the foregoing reasons, the opinion below should be reviewed because, in holding that the taxpayer had a property right in said system, said opinion is in conflict with the opinion of the United States Circuit Court of Appeals for the First Circuit in Affiliated Enterprises, Inc. v. Gruber, 85 Fed. (2d) 958, wherein it was held that the taxpayer had no property right therein after the first disclosure thereof, because a system of doing business cannot be patented and is not subject to protection by copyrights or trade-marks.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a transcript of the record and proceedings herein; and that the decree of the United States Circuit Court of Appeals for the Tenth Circuit be reversed by this Honorable Court, and your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just.

ALBERT J. GOULD,
Attorney for Petitioner.